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C O N F I D E N T I A L SECTION 01 OF 03 LONDON 11301

DEPARTMENT PASS TO LABOR, TREASURY AND FRB AND DOD

E.O. 11652: XGDS-1

TAGS: UK, ELAB, PINT, PGOV, EFIN, MPOL

SUBJECT: THE BATTLE OVER EXPENDITURE CUTS CONTINUES BUT
GOVERNMENT LIKELY TO RIDE THROUGH THE STORM

REF: (A) LONDON 11119; (B) LONDON 11041

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1. BEGIN SUMMARY: TRADE UNION REACTIONS TO PROPOSED

GOVERNMENT EXPENDITURE CUTS WERE TOUGHER THAN ANTICIPATED (REF A), BUT DESPITE THEIR SERIOUS OBJECTIONS TO THEM, TRADE UNION LEADERS DO NOT WANT A REAL CONFRONTATION WITH THE GOVERNMENT. THE LEADING TRADE UNION CHIEF IN BRITAIN, JACK JONES, TOLD US THIS MORNING JUST BEFORE HIS DEPARTURE FOR THE US (REF B): "THE TRADE UNION MOVEMENT IS NOT GOING TO PRESIDE OVER THE DEMISE OF THE LABOR GOVERNMENT," AND WILL NOT PRESS FOR DEFENSE CUTS. THIS TUC ATTITUDE HAS NO DOUBT AIDED CALLAGHAN AND MASON IN THEIR EFFORTS TO HOLD DEFENSE REDUCTIONS TO A MAXIMUM OF 100 MILLION POUNDS, AN EFFORT WHICH INFORMED SCURCES BELIEVE WILL PROBABLY BE SUCCESSFUL. NEIL KINNOCK (PROTECT), A LEADING MEMBER OF LABOR'S LEFT-WING TRIBUNE GROUP, ALSO STRESSED LABOR'S "LEFT-WING WAS NOT IN BUSINESS TO BRING DOWN THE GOVERNMENT." FOR THEIR PART, THE CONSERVATIVES ACCORDING TO LORD PETER THORNEYCROFT, CHAIRMAN OF THE PARTY, WOULD SUPPORT GOVERNMENT PROPOSALS TO CUT EXPENDITURES. IN THE MEANWHILE, CHANCELLOR DENIS HEALEY IS HAVING FURTHER DISCUSSIONS WITH THE CABINET TODAY -- ITS THIRD MEETING IN 24 HOURS -- ON THE DETAILS OF THE PROPOSED REDUCTIONS, AND THERE IS LIKELY TO BE SHARP OPPOSITION ESPECIALLY FROM MINISTERS LIKE BENN AND SHORT. DESPITE THIS CONTINUING SOUND AND FURY -- AND INCREASED UNEMPLOYMENT FIGURES ANNOUNCED TODAY WILL NOT HELP (SEPTEL) -- THE GOVERNMENT APPEARS LIKELY TO RIDE THROUGH THE STORM. END SUMMARY.

2. WHEN THE TUC ECONOMIC COMMITTEE MET YESTERDAY (JULY 19) IT PUT FORWARD AN ALTERNATIVE STRATEGY TO THE CHANCELLOR'S EXPENDITURE CUT PROPOSALS WHICH WOULD INCLUDE SELECTIVE IMPORT CONTROLS, RETENTION OF FOOD SUBSIDIES, AND FURTHER ACTION BY THE GOVERNMENT TO MITIGATE UNEMPLOYMENT. (UNEMPLOYMENT FIGURES JUST RELEASED ARE THE HIGHEST SINCE THE WAR -- 1.46 MILLION OR 6.3 PERCENT OF THE UK LABOR FORCE.) DAVID BASNETT, A LEADING MEMBER OF THE COMMITTEE, SAID THAT THE CHANCELLOR HAD EARLIER EMPHASIZED THAT THE GOVERNMENT'S NEED TO REMEDY ITS DEFICIT HAD PLACED IT TO THAT EXTENT IN THE HANDS OF ITS CREDITORS. FURTHERMORE, THE CHANCELLOR NOTED THAT, AS THE UPTURN COMES, THERE WOULD

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BE REAL COMPETITION TO FIND FUNDS WHICH COULD ONLY INCREASE THE LENDING RATE AND THEREFORE FUEL FURTHER INFLATION.

3. ON THE OTHER HAND, THE UNION LEADERS, IN THEIR DISCUSSION WITH HIM, WERE ANGERED BECAUSE AFTER TWICE ASKING FOR SACRIFICE IN THE FORM OF WAGE RESTRAINT, HE WAS RETURNING A THIRD TIME. MOREOVER, THEY HAD SERIOUS DOUBTS

ABOUT SOME OF HIS ECONOMIC ARGUMENTS, AND THEY WERE VERY ANNOYED THAT HE HAD LEFT THEM WITH NO ROOM FOR MANEUVER BY HANDING THEM IN EFFECT A 1-BILLION-POUND CUT AND ASKING THEM TO TAKE IT. THEY VERY MUCH REGRETTED THAT HE PLACED HIMSELF IN SUCH A DEFENSIVE WORLD POSTURE WITH REGARD TO THE POUND, WHICH THEY THINK IS SOUND. FINALLY, AS BASNETT EXPLAINED, THE UNION LEADERS WERE LOOKING OVER THEIR SHOULDERS AT RANK AND FILE REACTION. BUT BASNETT CONCLUDED: "WHILE WE ARE AT LOGGERHEADS WITH THE GOVERNMENT, WE CERTAINLY DON'T WANT TO BRING IT DOWN."

4. JACK JONES, IN OUR SECOND CONVERSATION WITH HIM ON THE SUBJECT SINCE THE CUTS DEBATE BEGAN TO REACH A CLI-

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MAX, REITERATED -- EVEN WITH GREATER EMPHASIS -- THAT THIS WAS NOT A GO-FOR-BROKE FIGHT WITH THE GOVERNMENT. PARAPHRASING WINSTON CHURCHILL, JONES SAID: "THE TUC WILL NOT PRESIDE OVER THE DEMISE OF THE LABOR GOVERNMENT." HE DOES NOT BELIEVE THAT THE TRIBUNE GROUP WILL VOTE AGAINST THE GOVERNMENT EITHER, "FOR THEY KNOW THAT WILL ONLY BRING THE TORIES IN AND SOME OF THEM OUT."
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JONES IS BY NO MEANS HAPPY WITH THE GOVERNMENT PROPOSALS OR THE TIMING. FAR FROM IT. HE BELIEVES "THAT THE GOVERNMENT PUT ITSELF IN A TRAP OF ITS OWN MAKING BY COMMITTING ITSELF TO A BILLION POUND CUT IN THE 1977-78 PERIOD AFTER HAVING AGREED TO SUBSTANTIAL CUTS FOR 1978-79. MOREOVER, HE SAYS, THE GOVERNMENT IS FAILING TO PROPERLY AND PUBLICLY ACKNOWLEDGE THE UNDERLYING IMPROVEMENT IN THE ECONOMY AND THUS HELP TO RESTORE CREDITOR CONFIDENCE. NONETHELESS, THE GOVERNMENT "IS STUCK WITH THEIR PROPOSALS." IN THEIR TALKS WITH HEALEY, THE CHANCELLOR HAD NOT DEFINED THE SPECIFIC AREA OF EXPENDITURE CUTS, BUT JONES DID SAY TO US -- IN RESPONSE TO A QUESTION -- THAT UNION LEADERS DID NOT SUGGEST ANY DEFENSE CUTS AS AN ALTERNATIVE TO OTHER REDUCTIONS. THIS TUC ATTITUDE HAS NO DOUBT AIDED CALLAGHAN AND MASON IN THEIR EFFORTS TO HOLD DEFENSE CUTS TO A MAXIMUM OF 100 MILLION POUNDS, AN EFFORT WHICH INFORMED SOURCES HERE BELIEVE WILL PROBABLY BE SUCCESSFUL. (JONES DID, HOWEVER, MAKE IT CLEAR THAT NOT ONLY WERE A SIGNIFICANT NUMBER OF UNION MEMBERS INVOLVED IN DEFENSE AND DEFENSE-RELATED INDUSTRIES BUT THAT HE WILL HAVE TO GO TO GOVERNMENT IN PROTEST AGAINST SOME DEFENSE-RELATED CLOSURES INCLUDED IN THE 1978-79 CUTS.)

5. THE BASIC PROBLEMS FOR THE TRADE UNIONS IS REALLY ONE OF TACTICS RATHER THAN STRATEGY IN DEALING WITH THE GOVERNMENT'S PROPOSALS. AS NORMAN WILLIS, TUC ASSISTANT GENERAL SECRETARY TOLD US: "THE OUTCOME WILL PROBABLY BE OUR NOT REPEAT NOT ENDORSING THE CUTS, SUGGESTING INSTEAD BETTER WAYS TO DEAL WITH THE PROBLEMS POSED BY THE GOVERNMENT' BUT NOT ENCOURAGING REBELLION. HOW THAT WILL FINALLY COME THROUGH, I DO NOT KNOW." BUT WILLIS MADE A POINT ALSO TO EMPHASIZE, AS HAD BASNETT AND JONES, THAT THIS WAS NOT AN ISSUE OF REAL CONFRONTATION WITH THE GOV-

ERNMENT. HE QUOTED A STATEMENT BY LEN MURRAY, TUC GENERAL SECRETARY, WHO SAID YESTERDAY: "THERE IS NO QUESTION AT THIS STATE, OR ANY OTHER OF THE TUC FAILING TO RECOGNIZE THE IMPORTANCE OF MAINTAINING THE SOCIAL CONTRACT OR REALIZATION OF THE FACT THAT THE SOCIAL CONTRACT NEEDS TO HAVE THE LABOR GOVERNMENT IN OFFICE."

6. WE ALSO TALKED WITH A LEADING TRIBUNITE, LABOR MP
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NEIL KINNOCK, ON WHAT HE EXPECTS THE LABOR LEFT TO DO. OUR QUESTION WAS BASED ON REPORTS THAT SOME OF THE LABOR LEFT (ACCORDING TO THE CHAIRMAN OF THE TRIBUNE GROUP, ARTHUR LATHAM) MIGHT ABSTAIN WHEN THE CRITICAL PARLIAMENT VOTE TAKES PLACE, PERHAPS NEXT WEEK. KINNOCK SAID THAT: "WE ARE NOT IN BUSINESS TO BRING DOWN GOVERNMENTS." HE CONFIDED THAT THE TRIBUNE STRATEGY WAS TO "KEEP THE GOVERNMENT GUESSING, KEEPING ON THE PRESSURE" BUT MAINLY IN ORDER TO GET IT TO MODIFY ITS PROPOSALS (SUCH AS BY GETTING SOME PUBLIC EXPENDITURE REVENUE FROM INCREASED TAXES AND THUS REDUCING THE CUTS ACCORDINGLY). BUT HE REITERATED: "WHATEVER HAPPENS IN THE ACTUAL CUTS, GOVERNMENT WOULD NOT BE BROUGHT DOWN." (KINNOCK THINKS THAT THE GOVERNMENT MAY WANT TO GET A QUICK DECISION BY INTEGRATING ITS PROPOSALS FOR EXPENDITURE CUTS IN A CONFIDENCE MOTION. THERE COULD BE TWO SEPARATE VOTES, TOO, HE ADDED, THE FIRST OF WHICH WOULD BE A SIMPLE MOTION ON THE PUBLIC EXPENDITURE CUTS, WHERE THERE COULD BE A COUPLE OF ABSTENTIONS, AND THEN A SECOND ONE -- A CONFIDENCE VOTE -- WHERE THERE WOULD BE NO OPPOSITION FROM THE LABOR LEFT. THE ACTUAL PROCEDURE, OF COURSE, HAS NOT YET BEEN DECIDED.)

7. THE CONSERVATIVES, FOR THEIR PART, ARE LIKELY TO SUPPORT GOVERNMENT PROPOSALS TO CUT PUBLIC EXPENDITURES, ACCORDING TO LORD PETER THORNEYCROFT, WHO SPOKE TO AN EMBASSY OFFICER ON JULY 19 DURING SEMI-ANNUAL BRIEFING HELD FOR REPRESENTATIVES OF DIPLOMATIC MISSIONS IN LONDON. HE EMPHASIZED THAT THE CONSERVATIVE PARTY HAD CONSISTENTLY CLAIMED IN LAST SEVERAL YEARS THAT PUBLIC EXPENDITURE HAS TO BE CUT IN ORDER TO IMPROVE BRITAIN'S ECONOMIC AND FINANCIAL SITUATION. HE ALSO STRESSED DIFFICULTIES CALLAGHAN HAD IN CONVINCING HIS OWN PARTY OF DESIRABILITY OF CUTTING PUBLIC EXPENDITURE. THORNEYCROFT ADDED THAT CONTINUING DEBATES IN THE CABINET AND IN THE PLP ARE SHARP AND THE OUTCOME BY NO MEANS ASSURED.

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8. THE CABINET, MEETING TODAY FOR THE THIRD TIME IN 24 HOURS, IS CONTINUING TO DISCUSS THE CUTS TO BE ALLOCATED TO EACH DEPARTMENT. EACH MINISTER IS BEING GIVEN AN OPPORTUNITY TO DEFEND HIS OWN DEPARTMENT. REPORTEDLY, PRIME MINISTER JAMES CALLAGHAN AND CHANCELLOR DENIS HEALEY WERE TAKING A TOUGH LINE ON REQUESTS FOR SPECIAL
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CONSIDERATION. (TWO MINISTERS, ENERGY SECRETARY ANTHONY WEDGWOOD BENN AND ENVIRONMENT SECRETARY PETER SHORE, ARE BELIEVED TO BE THE LEADERS OF THE ANTI-CUT GROUP IN THE CABINET.)

9. COMMENT: WHEN WE SPOKE WITH THE PRIME MINISTER AT THE DURHAM MINERS' GALA ON JULY 17, HE WAS CONFIDENT THAT THE TRADE UNIONS WOULD NOT OPPOSE THE GOVERNMENT PROPOSALS. IT IS CLEAR THAT WHILE THEY OBVIOUSLY CANNOT SUPPORT PUBLIC EXPENDITURE CUTS, THEIR UNWILLINGNESS TO JEOPARDIZE THE EXISTENCE OF THE LABOR GOVERNMENT IS GOING TO NEUTRALIZE THEIR OPPOSITION AND THUS ALLOW FOR TACIT ACQUIESCENCE TO THEM. BUT THE GOVERNMENT, TO PARAPHRASE DAVID BASNETT, HAS COME TO THE UNIONS TWICE WITH BEGGING BOWL IN HAND. THERE IS A LIMIT TO TUC ACQUIESCENCE AND IT MAY NOT BE EASY FOR TRADE UNIONS TO EXPLAIN THESE PROPOSALS TO THE RANK AND FILE, PARTICULARLY THOSE LAID OFF AS A RESULT OF THEM. (AS RECENTLY AS JULY 16 THE TUC SPECIAL CONGRESS PLEDGED TO FIGHT AGAINST FURTHER CUTS.)

10. SOME OF THE TUC REACTION MAY BE UNFAIR, PARTICULARLY IN BLAMING HEALEY FOR COMING TO THE WELL A THIRD TIME. IN THE LIGHT OF THE 5.3 BILLION POUND CREDIT FACILITY, WHICH MUST BE REPAID BY DECEMBER OR REFINANCED, HE HAD LITTLE ALTERNATIVE THAN TO PROPOSE THESE CUTS. HOWEVER, THE ULTIMATE TEST OF CONTINUED TUC LOYALTY WILL BE DEPENDENT -- AND TODAY'S HIGHER UNEMPLOYMENT FIGURES ARE NOT HELPFUL -- ON THE SUCCESS OF THE GOVERNMENT'S ECONOMIC STRATEGY. (SEE SEPTTEL FOR A BREAKDOWN OF THE CURRENT UNEMPLOYMENT FIGURES.)

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